

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name: <u>City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust</u>	County Oakland
Audit Date December 31, 2005	Opinion Date April 28, 2006	Date Accountant Report Submitted To State: June 30, 2006	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input checked="" type="checkbox"/> yes <input type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on individual federal assistance programs (program audits).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Single Audit Reports (ASLGU).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Certified Public Accountant (Firm Name): PLANTE & MORAN, PLLC			
Street Address 27400 Northwestern Highway	City Southfield	State MI	ZIP 48037
Accountant Signature <i>Plante & Moran, PLLC</i>			

**City of Pontiac
General Employees' Retiree Health
and Insurance Benefits Trust**

**Financial Report
December 31, 2005**

City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust

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Independent Auditor's Report

To the Board of Trustees
City of Pontiac General Employees' Retiree
Health and Insurance Benefits Trust

We have audited the accompanying statement of trust net assets of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (a component unit of the City of Pontiac, Michigan) as of December 31, 2005 and the related statement of changes in trust net assets for the year then ended. These financial statements are the responsibility of the board of trustees of the General Employees' Retiree Health and Insurance Benefits Plan and Trust of the City of Pontiac. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust as of December 31, 2005 and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis (identified in the table of contents) is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Plante & Moran, PLLC

April 28, 2006

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City of Pontiac

General Employees' Retiree Health and Insurance Benefits Trust

Management's Discussion and Analysis

Using this Annual Report

This annual report consists of two parts: (1) management's discussion and analysis (this section) and (2) the basic financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Condensed Financial Information

The table below compares key financial information in a condensed format between the current year and the prior year:

	Fiscal Year Ended December 31	
	2005	2004
Total assets	\$ 4,028,969	\$ 3,240,826
Total liabilities	<u>55,082</u>	<u>38,475</u>
Net trust assets	<u>\$ 3,973,887</u>	<u>\$ 3,202,351</u>
Net investment income	\$ 175,813	\$ 256,422
Contributions - Employer	612,331	721,866
General and administrative expenses	<u>16,608</u>	<u>21,527</u>
Net increase in trust net assets	<u>\$ 771,536</u>	<u>\$ 956,761</u>

City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust

Management's Discussion and Analysis (Continued)

Overall Fund Structure and Objectives

The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (the "Trust") exists to pay health care benefits to retired members. The Trust is currently accumulating assets to generate investment earnings and there are no benefits currently being paid. The excess of contributions over benefits paid will allow for additional funding to increase investment income to a level where the Trust will generate adequate earnings to pay future benefits. The public capital markets represent the primary source of investments.

Asset Allocation

The Trust has invested in a balanced mutual fund that provides exposure to both the equity and fixed income markets. Once an adequate funding level is established, the Trust is expected to deliver sufficient investment income over a very long period of time to satisfy the obligations to pay the benefits promised to the members of the Trust.

Investment Results

While returns were down from the prior year, both the domestic equity and domestic bond markets posted positive returns during the past year. In 2005, U.S. equities were again helped by strong profits, as well as by the expectation that the federal reserve would raise rates only one or two more times during the first quarter of 2006 and may even begin to lower rates by the end of 2006. U.S. bonds were helped by benign inflation reports and continued foreign investment in domestic bonds. The domestic equity market, as measured by the S&P 500 Index, returned 4.9 percent for the year. The fixed income market, as measured by the Lehman Aggregate Index, returned 2.0 percent for the year. The total fund returned \$771,536 for the year.

The total fund investment return must always be considered in a longer-term context. The asset allocation of each fund is built upon the foundation that the obligations of the Trust to pay the benefits promised to members and retirees are very long-term obligations. Accordingly, the board of trustees must make investment decisions that it believes will be the most beneficial to the Trust over many years, not just one or two years.

**City of Pontiac
General Employees' Retiree Health
and Insurance Benefits Trust**

**Statement of Trust Net Assets
December 31, 2005**

Assets

Investments at fair value - Mutual funds (Note 2)	\$ 3,982,899
Due from City of Pontiac	45,179
Due from City of Pontiac Police and Fire Retirement System	<u>891</u>
Total assets	4,028,969

Liabilities

Accounts payable	13,937
Due to General Employees' Retirement System	<u>41,145</u>
Total liabilities	<u>55,082</u>

Trust Net Assets	<u><u>\$ 3,973,887</u></u>
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City of Pontiac
General Employees' Retiree Health
and Insurance Benefits Trust

Statement of Changes in Trust Net Assets
Year Ended December 31, 2005

Additions

Interest and dividend income	\$ 102,538
Net appreciation in fair value of investments	<u>73,275</u>
Net investment income	175,813
Contributions	<u>612,331</u>
Total additions	788,144

Deductions

Legal services	188
Accounting	2,520
Actuary services	<u>13,900</u>
Total deductions	<u>16,608</u>

Net Increase in Trust Net Assets 771,536

Trust Net Assets - January 1, 2005 3,202,351

Trust Net Assets - December 31, 2005 \$ 3,973,887

City of Pontiac

General Employees' Retiree Health and Insurance Benefits Trust

Notes to Financial Statements
December 31, 2005

Note 1 - Summary of Significant Accounting Policies

The City of Pontiac (the "City") has established an irrevocable prefunded group health and insurance trust fund, the City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust (the "Trust"), for health, optical, dental, and life insurance benefits for retirees who are members of the General Employees' Retirement System of the City of Pontiac. Currently, the Trust is in the preliminary phases of accumulating assets to build a corpus, after which point, investment earnings will be used to pay these benefits. The Trust was created as an Internal Revenue Code 501(c)(9) Trust (VEBA). The General Employees' Retirement System (the "Retirement System") performs the Trust's accounting function.

Reporting Entity - The Trust is a component unit of the City of Pontiac, Michigan. The Trust does not hold securities of or loans to the City or the General Employees' Retirement System.

Basis of Accounting - The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust statements are prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Insurance costs are recognized when due and payable in accordance with the terms of the Trust.

Investments - Investments are reported at fair value. Mutual fund investments are valued at net asset value. Dividend income is recorded on the ex-dividend date. Income from other investments is recorded as earned on an accrual basis. In accordance with the policy of stating investments at fair value, net unrealized appreciation or depreciation for the year is reflected in the statement of changes in trust net assets.

Federal Income Taxes - The Trust is exempt from income tax under Section 501(a). The plan determination letter has not yet been received.

City of Pontiac

General Employees' Retiree Health and Insurance Benefits Trust

Notes to Financial Statements December 31, 2005

Note 2 - Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The System is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The retiree health care fund is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, debt or equity of certain small businesses, certain state and local government obligations, and certain other specified investment vehicles.

The System has designated one bank for the deposit of its funds. The System's deposits and investments are in accordance with statutory authority.

The System's cash and investments are subject to several types of risk, which are examined in more detail below:

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The System does not have an investment policy that restricts investment maturities. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Rating	Rating Organization
Mutual fund	\$ 1,198,395	AAA	S&P
Mutual fund	79,065	AA	S&P
Mutual fund	139,644	A	S&P
Mutual fund	134,052	BBB	S&P
Mutual fund	2,175	Unrated	N/A

City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust

Notes to Financial Statements December 31, 2005

Note 2 - Investments (Continued)

Credit Risk

State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The System has no investment policy that would further limit its investment choices. As of year end, the credit quality ratings of debt securities are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Weighted Average Maturity</u>
Mutual fund	\$ 1,553,331	7.1 years

Note 3 - Trust Contribution Information

The Trust is funded by employer contributions. The City is required to make minimum contributions in the amount of 3 percent of valuation payroll unless a lesser amount is actuarially determined to be necessary to actuarially fund the Plan. The ordinance that established the Trust requires annual funding of the actuarial rate or 3 percent of valuation payroll.

Note 4 - Trustees

The City of Pontiac General Employees' Retiree Health and Insurance Benefits Trust as of December 31, 2005 had two trustees who sit by virtue of their position, two who were appointed by the City of Pontiac General Employees' Retirement System and the City of Pontiac, and one who was elected by the retirees.

June 23, 2006

To Mr. Charlie Harrison III, Chairman (GERS)
To Mr. Craig Storum, Chairman (PFRS)
To Mr. Ray Cochran, Chairman (General VEBA)
To Mr. Brian Lee, Chairman (Police and Fire VEBA)
To the City of Pontiac Retirement Board's
General Employees Retirement System
and Police and Fire Retirement System
47450 Woodward Ave
Pontiac, MI 48342

Dear Mr. Harrison, Mr. Storum, Mr. Cochran, and Mr. Lee:

We recently completed the audits of the General Employees Retirement System and the Police and Fire Retirement System (the "Systems"), as well as the related VEBAs, for the year ended December 31, 2005. We continue to be impressed with the organized and thorough manner in which Deborah Munson prepared for the audit. Her assistance in preparing the necessary schedules was greatly appreciated. As a result of the audit, we offer the following comments and recommendations for your consideration:

Retiree Health Care Benefits

The Governmental Accounting Standards Board recently released Statement Number 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidance for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid.

The new pronouncement will require the Systems to obtain a valuation of the obligation to provide retiree health care benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any underfunding must be reported as a liability on the government-wide statement of net assets.

The GASB statement has provided substantial incentive to fund the obligation in accordance with the annual recommended contribution. In addition to the normal fairness issue of paying for a service as you use it, the GASB has directed that lower rates of return be used for evaluating the annual recommended contribution in situations where the recommended contribution is not being funded. This will significantly increase the calculation of the following year's contribution. As a result, funding the contribution on a current basis should reduce the long-run cost. The accounting change will become effective for the Systems for the year ended December 31, 2008. GASB Statement Number 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, is effective for the year ending December 31, 2007. This statement impacts the reporting and disclosures made by the plan.

Document Storage

As mentioned in the past, the Systems are responsible for keeping many important documents and records that often cannot be recreated (i.e., board minutes, member files, financial records, etc.). Given the very limited space allocated to the Systems' offices, it is difficult to provide adequate storage. It is imperative that the Systems maintain storage space that is not only well organized, but is also secure and fireproof. We recommend that the Systems review their current operating space and document storage facilities in an effort to improve conditions in order to ensure the safety of the related records.

In the past, we have suggested looking into document imaging and understand the Systems have begun to research various options as they relate to different imaging systems. Document imaging would mitigate the need to retain paper files for extended periods. Documents would instead be scanned to create an electronic backup. Document imaging, while not necessarily a new technology, is being used increasingly as a means to provide a safe and effective back-up solution while maximizing space limitations.

We also continue to suggest that the Systems should consider various aspects of disaster recovery. If there were a fire or other catastrophe and the paper records and/or computer system were destroyed, the Systems should have a disaster recovery plan in place.

Other Accounting Matters

During our testing, we noted various miscellaneous differences between the amounts recorded as receivables/payables from/to other systems. For example, the receivable from the Police and Fire VEBA recorded in the Police and Fire Retirement System is different from the payable recorded in the Police and Fire VEBA. This also occurred in some of the other systems. Although all the amounts were small, we recommend that the Systems go through and reconcile the differences to make sure the receivables and payables mirror each other.

To the Respective Chairmen
City of Pontiac Retirement Boards

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June 23, 2006

We would like to thank the Systems' staff for the excellent cooperation extended to us during the audit. We look forward to discussing our comments and recommendations with you. If you have any questions or require assistance in the implementation of our recommendations, please call us at your convenience.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in black ink that reads "Beth Bialy". The signature is written in a cursive, flowing style.

Beth A. Bialy

A handwritten signature in black ink that reads "Wendy Trumbull". The signature is written in a cursive, flowing style.

Wendy N. Trumbull